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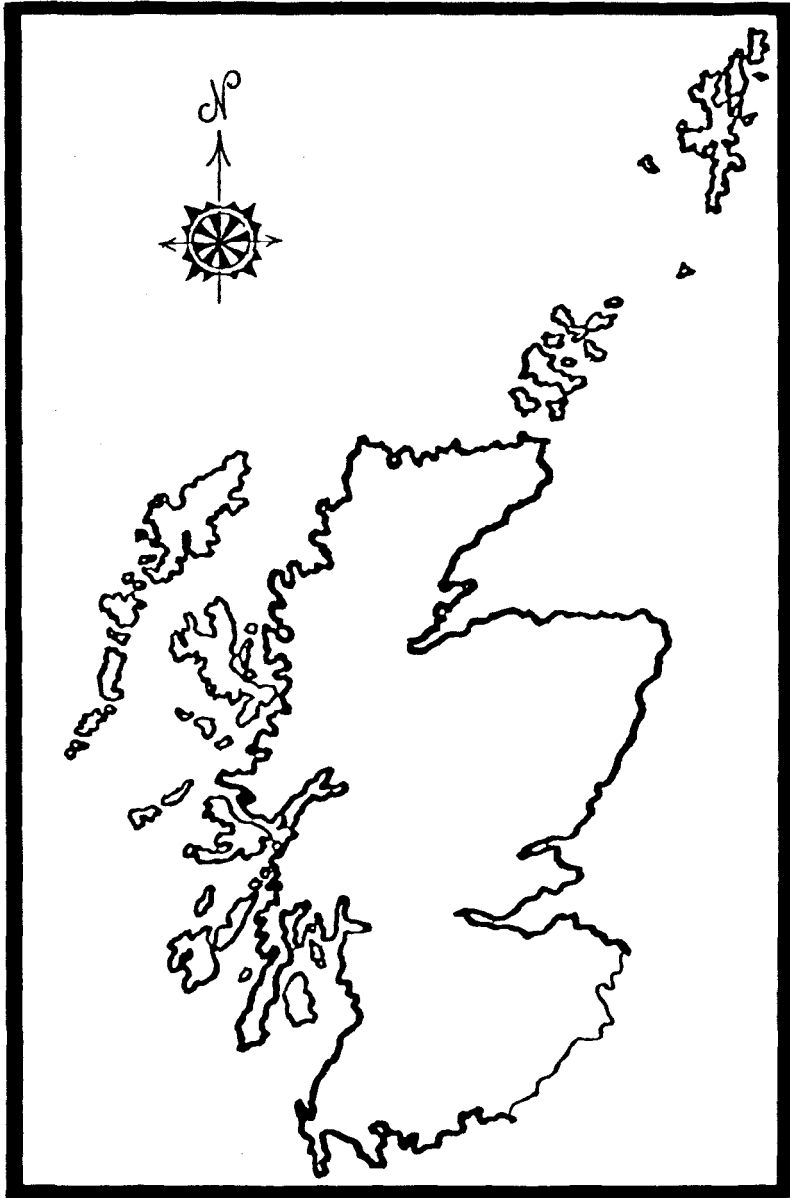
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THE FRASER OF ALLANDER INSTITUTE

QUARTERLY ECONOMIC COMMENTARY



April 1978

The Fraser of Allander Institute for Research on the Scottish Economy was established in the University of Strathclyde on 1 January 1975, as the result of a generous donation from the Hugh Fraser Foundation. Its principal function is to carry out research on the Scottish economy and its research programme includes the analysis of short-term movements in economic activity. The results of this work are published each January, April, July and October in the Institute's Quarterly Economic Commentary. The Institute also publishes a series of Research Monographs to provide an outlet for original quantitative research on the Scottish economy, and a series of occasional essays on economic policy entitled Speculative Papers.

The Institute wishes to thank The Scotsman Publications Limited for its financial support in the appointment of a Research Fellow to work on medium-term forecasting.

The Fraser of Allander Institute, University of Strathclyde,
100 Montrose Street, GLASGOW G4 0LZ.
Telephone 041-552-4400 Extension 3303

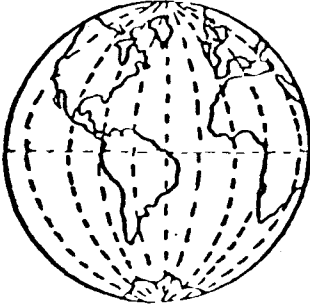
CONTENTS

1.	Review of the Quarter's Economic Trends	
	The World Economy	1
	The United Kingdom Economy	3
2.	The Scottish Economy	
	Indicators of Economic Activity	5
	Industrial Performance	10
	Employment and Unemployment	18
	Outlook and Appraisal	29
3.	Summary	33
4.	Note	
	Econometric Forecasts for Scotland	34
5.	Special Article	
	Social Indicators	
	By M W Danson, M E Glassford and	
	J W McGilvray	37
6.	Publications of the Institute	

Editor: D N F Bell

Contributors: M W Danson
M E Glassford
F X Kirwan
J W McGilvray
A J Morton
A A Wingfield

REVIEW OF THE QUARTER'S ECONOMIC TRENDS



THE WORLD ECONOMY

The more detailed and disaggregated data now available confirm that 1977 was indeed a year of stagnating industrial production and rising unemployment in the major world economies with the exception of Japan and the United States. It was the year of the financial "recovery" not just in Britain, but also in Italy and France. The contractionary stance of both fiscal and monetary policy in late 1975 and through 1976 had the expected effects on financial variables.

Current balance of payments deficits contracted, the rate of price inflation decelerated and nominal rates of interest began to fall. The impact on the real economy was equally predictable, output in general grew at less than its trend rate and unemployment rose. The exception to this general pattern was the steady expansion of demand and buoyant labour market conditions in the United States. Reflation in a deflationary world has the obvious consequence of promoting a more rapid growth of imports and a deterioration on the current account of the balance of payments in the reflation country. Given the role of the dollar in the international monetary system, this has led to considerable instability on foreign exchange markets, exacerbated by the failure of the American legislature to pass the more important parts of the Carter energy programme, or to move towards decontrolling energy prices in the US.

Prospects for 1978 are uncertain. Another year of slow growth appears likely, as policy makers everywhere refrain from stimulating demand for fear of jeopardising the financial "recovery", and attempt to restrain unemployment with an assortment of ad hoc job creation measures whose impact on the real economy is primarily of a cosmetic nature. In this light prospects for the major economies might be assessed as follows. In the UNITED STATES GDP is expected to grow by 4-4½% this year compared to 4.9% in 1977. In the absence of further stimulatory action the growth rate is expected to decline

substantially in the latter half of the year. Unemployment, which fell by 1%, seasonally adjusted, over the year to December 1977, may therefore begin to rise as the OECD estimate that real GDP growth of $3\frac{3}{4}\%$ is needed in order to attain a stable unemployment level of $6\frac{1}{2}\%$ of the labour force. The rate of increase of retail prices is expected to accelerate this year, due to the effects of a depreciating dollar, a reduction in the rate of productivity growth, and increases in statutory minimum wages and social insurance contributions.

A similar slowing down in the rate of growth of GNP in the second half of this year is also predicted for JAPAN. The recovery to date has been largely the result of government spending and export demand, however fiscal policy is set to become less expansionary as the year progresses, and the growth of exports is likely to be restrained by an appreciating yen and by direct discrimination against Japanese exports. The OECD forecasts GNP growth of 5% this year compared to 6% in 1977, with the rate slowing down to $3\frac{1}{4}\%$ in the second half of 1978. GDP growth in GERMANY amounted to only 2.4% last year, well below the government target. A higher growth rate is expected in 1978 as fiscal policy has become more expansionary. This is reflected in an increasing public sector deficit following two successive years of contraction. Employment fell throughout 1977, and the OECD forecast GDP growth of 3% will be insufficient to redress this and prevent a further rise in unemployment.

In FRANCE GDP growth is likely to be of the order of 3% compared to $2\frac{1}{2}\%$ last year. Inflation may fall further and rising real personal disposable incomes should lead to somewhat higher consumption than in 1977, but domestic demand generally will be far from buoyant. Further deflationary measures seem likely in ITALY if money supply and price inflation targets agreed with the EEC and IMF are to be attained. In this case GDP growth may not exceed the rate of 1.8% achieved in 1977, with consequent further rises in unemployment. In the EEC as a whole, real GDP grew by $2\frac{1}{2}\%$ last year, and growth is expected to be of the order of $3-3\frac{1}{2}\%$ in 1978. This falls well short of the Commission estimate of $4\frac{1}{2}\%$ necessary to stabilise the present level of unemployment. Consequently, it is expected that 5.8% of the EEC labour force will be unemployed in 1978, compared to 5.5% in 1977, and an average level of 2.8% over the years 1970-74.